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RSX

ANNUAL REPORT 2001

ROYAL SOVEREIGN EXPLORATION INC.



CORPORATE PROFILE

Royal Sovereign Exploration Inc. is a growth oriented oil and gas exploration company with headquarters in Calgary, Alberta. The Company is committed to increasing shareholder value by using technical expertise to develop oil and gas reserves through acquisitions and drilling. Royal Sovereign's shares trade on the Canadian Venture Exchange under the symbol RSX.

ANNUAL GENERAL MEETING

The annual general meeting of the shareholders of Royal Sovereign Exploration Inc. will be held on June 6, 2002 at 10:00 am at the offices of Macleod Dixon LLP, Suite 3700, 400 – 3rd Avenue S.W., Calgary, Alberta.

HIGHLIGHTS

2001

... was a year of significant growth. In it's short history, Royal Sovereign has built a stable base of long reserve life production and major growth in all sectors was achieved in a five month period.

Production	October 2001	30 Boepd
	December 2001	135 Boepd
	February 2002	160 Boepd
Proved Plus Probable Reserves	October 2001	31 Mstboe
	January 2002	1,678 Mstboe
Reserves Per 1000 Shares	October 2001	2.8 Bbls/1000 Shares
	January 2002	108 Bbls/1000 Shares
Reserve Life Index	Total proved reserves	9.4 years
	Total proved plus probable reserves	14.8 years
Finding and Development Costs	Proved Producing	\$10.93/Boe
	Total Proved	\$6.76/Boe
	Established Reserves*	\$3.96/Boe
Recycle Ratio	Total Proved Reserves	2.3 : 1
	Total Proved plus Probable Reserves	3.9 : 1

* Established reserves equals total proved plus 50% probable.



PRESIDENT'S MESSAGE



The year 2001 was a challenging year for the petroleum industry. Merger and acquisition activity, largely by American based buyers, totaled \$39 billion during the period. The majority of this spending was in the first and second quarters of the year propelled by

high commodity prices. West Texas Intermediate crude traded at levels of US\$30/Stb and more dramatically AECO Gas traded at CDN\$7-10/Mcf, up approximately 200 - 300% over the year 2000.

Challenging Year For Producers Concerns of a slowing worldwide economy, the World Trade Centre tragedy and North American gas oversupply, caused the most rapid decline in commodity prices since 1986.

West Texas Intermediate plunged to US\$19.40/Stb by December with AECO Gas declining to the CDN\$3.00/Mcf level. Producers immediately responded to the price collapse by slashing exploration budgets and attempting to sell properties in order to re-align debt to cash flow ratios. As we enter 2002, the industry does not forecast a sustained price recovery until late in the year or in 2003.

Initial Acquisition Royal Sovereign is well positioned to capitalize on the acquisition and drilling opportunities arising from the recent commodity price collapse. After staffing was completed in September 2001, the Company immediately acquired an interest in the prolific Weyburn Unit in Southeast Saskatchewan. This unit is under CO₂ miscible flood and currently produces approximately 22,000 Bopd gross with in excess of 100 million barrels of proven oil yet to be recovered. Net production to Royal Sovereign improved from 80 Bopd to 100 Bopd in the last quarter of the year as a result of the miscible flood success.

Drilling Successes The Company also participated in the drilling of two (0.8 net) exploration wells late in the quarter resulting in one new pool wildcat oil discovery in the Karr area of Northern Alberta and one dry hole. The Company was also successful in acquiring probable oil reserves in the Peco area of West Central Alberta via crown land sale.

Low F & D Costs The Royal Sovereign exploration team is targeting proven finding and development costs of \$7.00–9.00/Boe. Over the five previous years the same exploration team added reserves at an average of \$7.63/Boe for their company, ranking in the upper 10% of the industry. The Company is pleased to report total proved finding and development costs of \$6.76/Boe and established finding costs of \$3.96/Boe for the year 2001.

High-impact Prospects The growth provided by our Weyburn Unit acquisition and recent drilling success allows Royal Sovereign the opportunity to participate in high-impact, high-reserve potential plays. The Company has dedicated approximately 10% of its exploration budget to these projects, which, if successful, can add substantially to the Company's share value.


“Royal Sovereign is a well financed junior oil and gas company with no debt and a very stable long life production base. The Company is in an enviable position to take advantage of the opportunities that arise from commodity price fluctuations.”

Well Financed In late 2001 and early 2002, Royal Sovereign completed a private placement of common and flow-through shares. A total of \$4.7 million of equity was raised to fund ongoing acquisitions and drilling programs. Royal Sovereign is a well financed junior oil and gas company with no debt and a very stable long life production base. The Company is in an enviable position to take advantage of the opportunities that arise from commodity price fluctuations.

Our Board of Directors has changed over the past year to reflect our activity and shareholder base. We were pleased to appoint Mr. Michael Rose and Mr. Ian Fergusson to the Board in November 2001 and February 2002 respectively. These individuals bring substantial oil and gas exploration and investment expertise to an already experienced Board.

We also thank the Royal Sovereign management team which is largely responsible for the Company's increased production, reserves and net asset value.

On behalf of the Board of Directors,

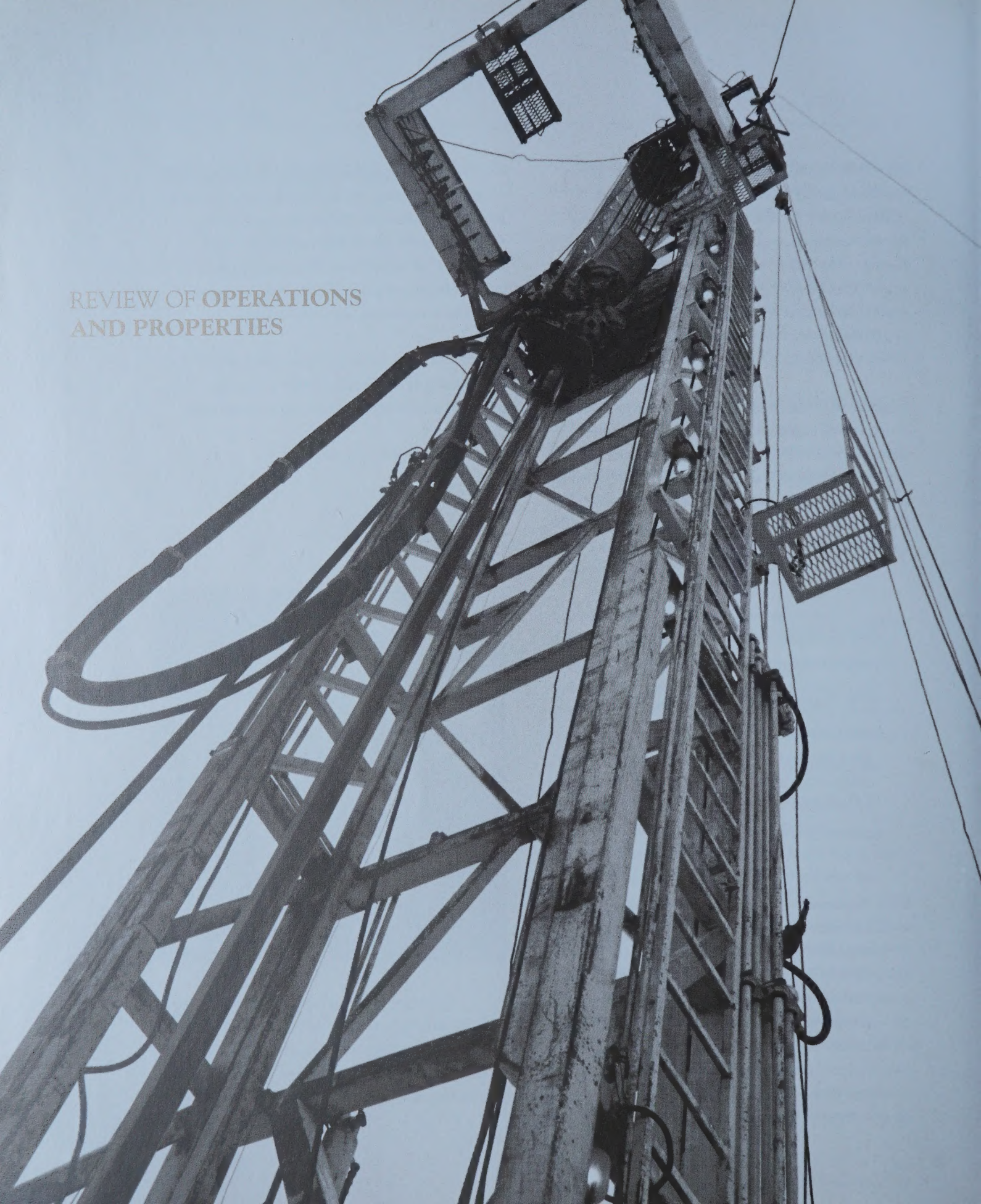


Lee A. Baker, P. Geol.

President

April 10, 2002

REVIEW OF OPERATIONS
AND PROPERTIES



STRATEGY FOR 2002

- Generate profitable growth through a combination of exploration, exploitation and property acquisitions
- Maintain strict adherence to finding and development cost targets
- Expose the Company to selected high-impact prospects
- Focus on a full cycle exploration strategy
- Ensure property acquisitions have future growth and optimization potential

FINDING AND DEVELOPMENT COSTS

Royal Sovereign calculates finding and development costs by including all capital expenditures related to exploration, development, equipment and property acquisitions and divestitures. The Company also includes all general and administrative costs. Fixed assets costs are not included.

2001 Reserve Additions

Proved Producing Reserves	430 Mstboe
Total Proved Reserves	695 Mstboe
Established Reserves*	1,186 Mstboe

2001 Cost of Additions

Capital Expenditures	\$ 4,110,186
Additional Expenditures to Complete and Equip	200,000
General and Administrative Expense	390,691
Total Cost of Additions	\$ 4,700,877

2001 Finding and Development Costs

Proved Producing Reserves	\$ 10.93/Boe
Total Proved Reserves	\$ 6.76/Boe
Established Reserves*	\$ 3.96/Boe

* Established reserves equals total proved plus 50% probable.

REVIEW OF OPERATIONS AND PROPERTIES

CRUDE OIL AND NATURAL GAS RESERVES

The volumes and present value of Royal Sovereign's reserves have been evaluated by Gilbert Laustsen Jung Associates Ltd. effective January 1, 2002. The following table is a summary of the Company's gross and net share of reserves as well as the future cash flow, undiscounted and discounted at 8, 10, 12, 15, 18 and 20% per annum.

	Proved Producing	Total Proved	Proved Plus Probable Producing	Total Proved Plus Probable	Total Established*
Marketable Reserves					
Oil - Mstb					
Gross	61,873	101,767	93,590	197,578	149,672
Company Interest	401	642	590	1,408	1,025
Net After Royalties	311	476	445	1,016	746
Gas - Mmcf					
Gross	2,293	2,713	3,054	5,167	3,940
Company Interest	132	242	330	1,138	690
Net After Royalties	77	139	189	658	399
Natural Gas Liquids - Mstb					
Gross	16	31	43	5,190	2,611
Company Interest	6	12	17	81	47
Net After Royalties	4	7	10	50	29
Oil Equivalent - Mboe					
Gross	62,272	102,250	94,142	203,629	152,940
Company Interest	429	695	662	1,678	1,186
Net After Royalties	327	506	486	1,176	841
Before Tax Present Value - \$Millions					
Undiscounted	4.12	5.25	7.36	17.74	11.50
8%	2.87	3.45	4.22	8.85	6.15
10%	2.67	3.16	3.83	7.78	5.47
12%	2.50	2.91	3.50	6.92	4.92
15%	2.28	2.60	3.11	5.92	4.26
18%	2.09	2.35	2.81	5.15	3.75
20%	1.99	2.21	2.63	4.73	3.47

* Established reserves equals total proved plus 50% probable.

PROSPECT AREAS

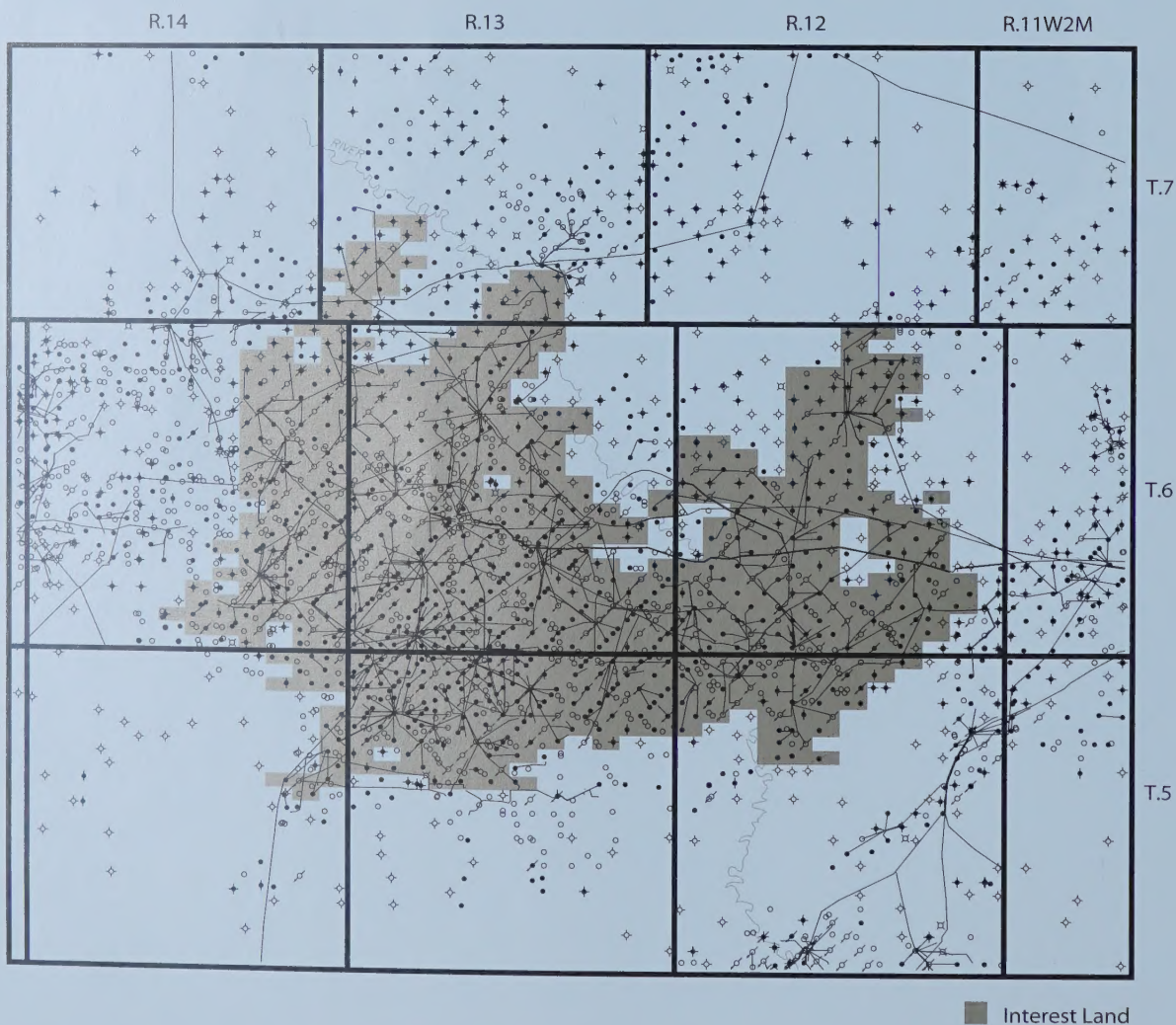


REVIEW OF OPERATIONS AND PROPERTIES

MAJOR PROPERTIES

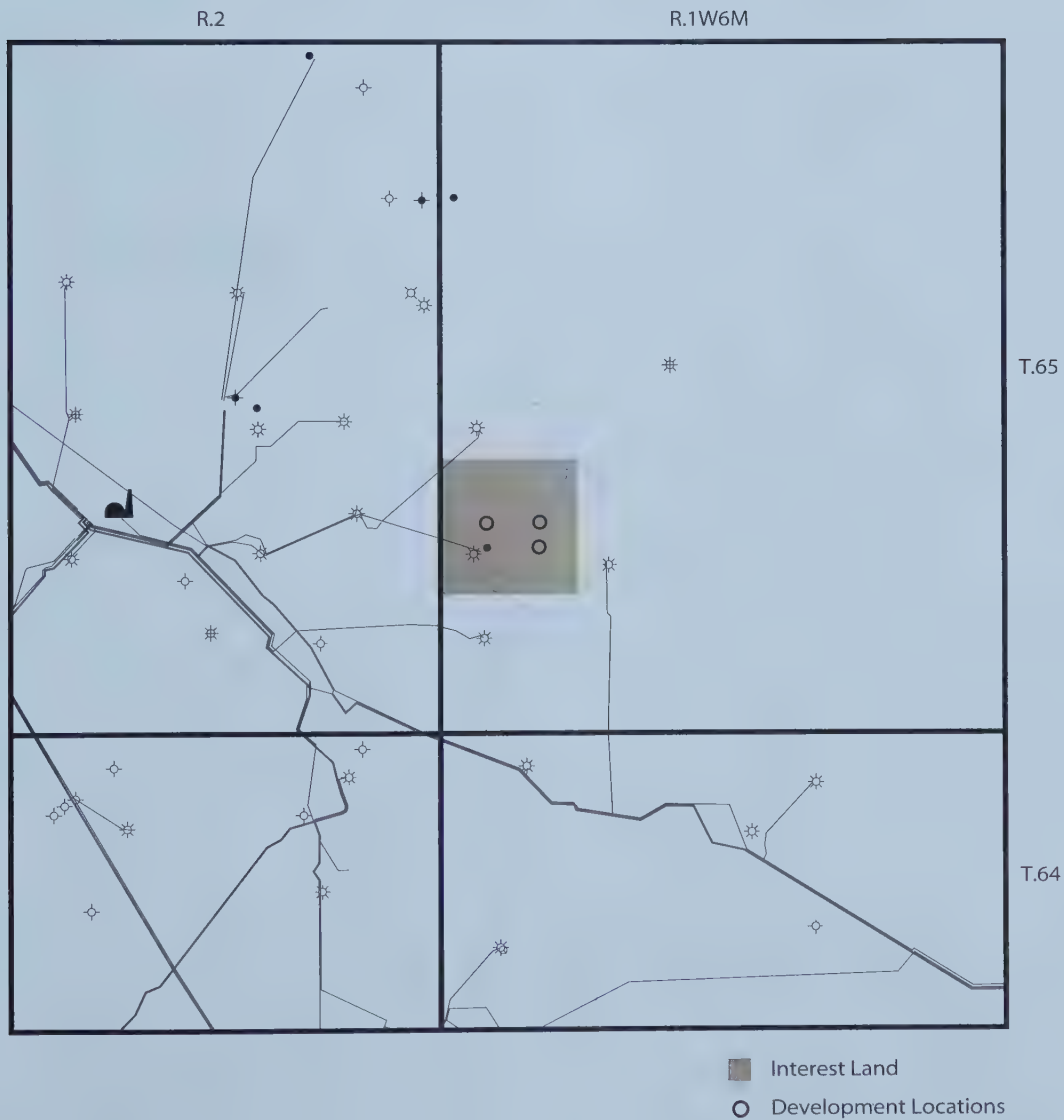
WEYBURN UNIT, SASKATCHEWAN

- 0.44792% working interest
- 653 producing oil wells
- Gross unit production 22,000 Bopd
- Gross total proved reserves 101 million barrels
- Reserve life index 14.2 years
- CO₂ miscible flood underway



KARR, ALBERTA

- 40% working interest
- Dunvegan zone – oil discovery drilled December 2001
- Three development locations identified
- Net proved plus probable reserves: 580 Mstboe
- Reserve life index 9.7 years

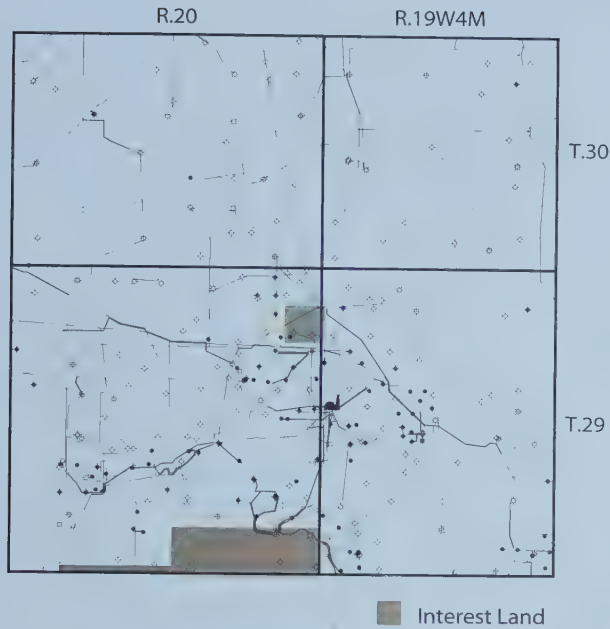


- 100% working interest
- Drilling location - summer 2002
- Belly River 'O' Sand
- Potential 120 Bopd, 250 Mstboe reserves
- Pipeline infrastructure in place



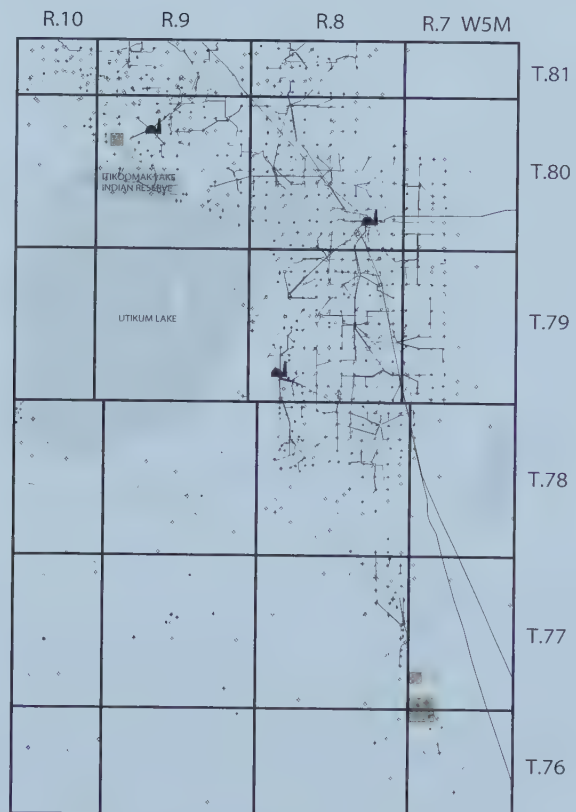
■ Interest Land
 ○ Drilling Location

MINOR PROPERTIES



DRUMHELLER, ALBERTA

- 55% working interest
- One producing Nisku oil well
- Low operating costs
- High volume lift



NIPISI, ALBERTA

- 12.5 to 50% working interest
- Two producing Gilwood oil wells
- High netback production



MANAGEMENT'S DISCUSSION
AND ANALYSIS

CORPORATE

The Corporation was incorporated under the Business Corporations Act (Alberta) on May 6, 1997 as Royal Sovereign Exploration Inc. The Corporation closed its initial junior capital pool public offering on March 30, 1998 and its shares were listed on The Alberta Stock Exchange and began trading on April 15, 1998. The Alberta Stock Exchange merged with the Vancouver Stock Exchange to form the Canadian Venture Exchange Inc. ("CDNX") on November 29, 1999. Royal Sovereign is a reporting issuer in the Provinces of Alberta and British Columbia.

On November 14, 2001, the Corporation completed the acquisition of all of the securities of 929190 Alberta Ltd., a private oil and gas company, as its Qualifying Transaction. Royal Sovereign and 929190 Alberta Ltd. amalgamated on November 16, 2001. Royal Sovereign has no subsidiaries.

929190 Alberta Ltd. was incorporated on April 11, 2001 under the Business Corporations Act (Alberta). By Articles of Amendment dated June 12, 2001, 929190 Alberta Ltd. removed its private company restrictions.

On July 13, 2001, 929190 Alberta Ltd. acquired petroleum and natural gas rights and tangible assets located in the areas of Drumheller and Nipisi, Alberta for an aggregate purchase price of approximately \$336,500 in cash. Each of the properties has producing reserves. The assets consist of four gross (1.18 net) producing oil wells (three wells located at Nipisi and one well at Drumheller). The three wells at Nipisi are operated by a third party while the Corporation is the operator of the well at Drumheller.

On September 20, 2001, the Corporation entered into an agreement of purchase and sale with a private limited partnership at arm's length to the Corporation to purchase a 0.44792% interest in the Weyburn Unit located in Southeast Saskatchewan and a non-unitized well in the Weyburn area. The Acquisition Agreement was subject to rights of first refusal which expired on November 15, 2001. The aggregate purchase price for the assets was approximately \$3,128,000. The acquisition closed on December 14, 2001. The Weyburn Unit is operated by EnCana Corporation and produces light crude oil (28 - 31° API) from oil wells unitized in the Mississippian Midale Formation.

“Royal Sovereign’s 2001 revenue from oil and gas sales before royalty was \$155,000 with significant revenue from the Weyburn Unit commencing December 14, 2001. Oil and gas production exited the year at 135 Boepd.”

Production in the unit commenced in 1955 and the operator initiated, in the third quarter of 2000, an enhanced oil recovery project via miscible CO₂ injection. Current unit production is approximately 22,000 Bopd (100 Bopd net) from 653 producing oil wells and production from the non-unitized well is approximately 4 Bopd (net).

In July and August 2001, 929190 Alberta Ltd. completed a private placement of 6,700,000 common shares at \$0.30/share for gross proceeds of \$2,010,000. Royal Sovereign agreed to acquire all of the issued and outstanding shares of 929190 Alberta Ltd. by way of a take-over bid or amalgamation. All the shareholders of 929190 Alberta Ltd. agreed to tender their shares to the bid and vote their shares in favour of amalgamation. The acquisition was Royal Sovereign's qualifying transaction within the meaning of the Canadian Venture Exchange's policies respecting capital pool companies.

On December 14 and December 28, 2001, Royal Sovereign issued common shares at \$0.50 per share and flow-through common shares at \$0.60 per share. Aggregate gross proceeds of \$2,479,422 were raised; 4,199,036 common shares were issued. Royal Sovereign completed additional closings for common shares on February 6 and 15, 2002 for aggregate gross proceeds of \$2,190,000; 4,380,000 common shares were issued. As of February 15, 2002, total common shares outstanding were 19,872,572.

Royal Sovereign's 2001 revenue from oil and gas sales before royalties was \$155,000 with significant revenue from the Weyburn Unit commencing December 14, 2001. Oil and gas production exited the year at 135 Boepd. The average selling price for crude oil was \$28.36 per barrel.

- Total production for the year was 5,512 Boe.
- Royalties totalled \$28,000 or \$5.09/Boe.
- Production expenses were \$40,000 or \$7.33/Boe.
- General and administrative costs were \$391,000.
- Royal Sovereign was debt free on December 31, 2001.
- Funds from operations were (\$290,000).
- Net loss was (\$192,000) or (\$0.02) per share.
- Capital expenditures totalled \$4,110,000 consisting of:

– Property acquisitions	\$ 3,361,000
– Land	\$ 107,000
– Drilling/completions	\$ 548,000
– Office expenses	\$ 94,000
- Total common shares outstanding as at December 31, 2001 were 15,492,572.

MANAGEMENT'S REPORT

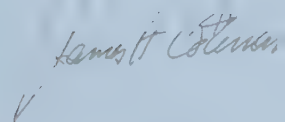
The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. The accompanying financial statements have been prepared using policies and procedures established by management and reflect fairly the Company's financial position, results of operations and changes in financial position, within reasonable limits of materiality and within the framework of the accounting policies outlined in the notes to the financial statements.

Management is responsible for the accuracy and integrity of the information contained in this annual report.


Management has established and maintains a system of internal control which is designed to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The financial statements have been examined by external auditors. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and the financial condition of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the financial statements with management and the external auditors. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.



James H. Coleman
Chairman
March 18, 2002



Lee A. Baker, P. Geol.
President

Auditor's Report on Royal Sovereign Exploration Inc.

We have audited the balance sheet of Royal Sovereign Exploration Inc. as at December 31, 2001 and the statements of loss and deficit and cash flow for the period of commencement of operations, June 8, 2001 to December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and the results of its operations and its cash flow for the period then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Calgary, Alberta

March 18, 2002

BALANCE SHEET

December 31, 2001

Assets**Current assets**

Cash and cash equivalents	\$ 115,928
Accounts receivable	334,441
Prepaid expenses	55,602
	<hr/> 505,971

Future income tax asset (note 4)	177,785
Property and equipment (note 5)	4,031,258
	<hr/> \$ 4,715,014

Liabilities**Current liabilities**


Accounts payable and accrued liabilities	\$ 497,015
Future removal and site restoration costs	909

Shareholders' Equity

Share capital (note 6)	4,409,006
Deficit	(191,916)
	<hr/> 4,217,090
	<hr/> \$ 4,715,014

See accompanying notes to financial statements

Approved by the Board of Directors



Director



Director

STATEMENT OF LOSS AND DEFICIT

Period of Commencement of Operations, June 8, 2001 to December 31, 2001

Oil and gas sales (net of royalties)	\$ 127,046
Interest income	14,138
	<u>141,184</u>
Production	40,401
General and administrative	390,691
Depletion and depreciation	79,837
	<u>510,929</u>
Loss before income taxes	(369,745)
Income tax recovery (note 4)	177,829
Net loss, being deficit, end of period	<u>\$ (191,916)</u>
Basic and diluted net loss per share (note 7)	<u>\$ (0.02)</u>

See accompanying notes to financial statements

STATEMENT OF CASH FLOW

Period of Commencement of Operations, June 8, 2001 to December 31, 2001

Operating activities

Net loss	\$ (191,916)
Add (deduct) items not involving cash	
Depletion and depreciation	79,837
Future income tax recovery	(177,829)
Cash used in operations	(289,908)
Changes in non-cash working capital	(123,399)
Cash used in operating activities	(413,307)

Financing activities

Issuance of share capital	4,489,482
Share issuance and acquisition costs	(430,332)
Changes in non-cash working capital	(58,164)
Cash from financing activities	4,000,986

Investing activities

Acquisition of property and equipment	(4,110,186)
Cash received on business combination (note 2)	388,208
Changes in non-cash working capital	250,227
Cash used in investing activities	(3,471,751)
Cash inflow, being cash, end of period	\$ 115,928
Basic and diluted cash used in operations per share (note 7)	\$ (0.04)

See accompanying notes to financial statements

1997 TO 1999 FINANCIAL STATEMENTS

Background Information

The Company was incorporated under the laws of Alberta on May 6, 1997 as a Capital Pool Corporation as defined by Alberta Securities Rule 46-501. On November 14, 2001, the Company completed its qualifying transaction. This transaction has been accounted for as a reverse takeover as discussed in note 2, resulting in 929190 Alberta Ltd. being the continuing company. 929190 Alberta Ltd. commenced operations June 8, 2001.

The Company's activities are the exploration for and development of oil and gas properties in Western Canada.

Transaction with 929190 Alberta Ltd.

Pursuant to a letter of intent dated May 29, 2001 and a share purchase agreement dated July 11, 2001, the shareholders of Royal Sovereign Exploration Inc. ("Royal Sovereign") agreed to acquire all of the issued and outstanding shares of 929190 Alberta Ltd. ("929190 Alberta Ltd.").

On November 14, 2001, under the terms of the share purchase agreement, Royal Sovereign issued 6,700,200 common shares and 502,501 agent's options for the 6,700,200 issued and outstanding shares and the 502,501 agent's options of 929190 Alberta Ltd. In addition, Royal Sovereign granted 2,008,667 stock options to the officers and directors of 929190 Alberta Ltd. at an exercise price of \$0.30 per share. Some of the directors of Royal Sovereign are also directors of 929190 Alberta Ltd. This transaction constitutes Royal Sovereign's qualifying transaction.

The former officers and directors of Royal Sovereign also transferred 1,900,000 of their escrowed shares of the Company to officers and directors of 929190 Alberta Ltd. at prices between \$0.085 and \$0.10 per share.

Subsequent to the issuance of common shares, the former shareholders of 929190 Alberta Ltd. owned 77% of the issued and outstanding shares of the combined Company. As a result, the business combination has been accounted for as a reverse takeover using the purchase method with 929190 Alberta Ltd. being the acquiring company. In accordance with reverse takeover accounting, the financial statements are a continuation of 929190 Alberta Ltd. The capital structure (authorized and issued common shares) is that of Royal Sovereign and the stated value of the share capital is that of 929190 Alberta Ltd. The results of operations of Royal Sovereign are included in the accounts from the closing date of the transaction, November 14, 2001.

On November 16, 2001, Royal Sovereign and 929190 Alberta Ltd. were amalgamated and continued business operations under the name "Royal Sovereign Exploration Inc."

The purchase price was allocated as follows:

Cash	\$ 388,208
Accounts receivable	5,281
Accounts payable and accrued liabilities	(43,589)
Total purchase price	\$ 349,900

Consideration:

Share capital issued (note 6(b))	\$ 304,800
Acquisition costs	45,100
Total consideration	\$ 349,900

3. Summary of significant accounting policies

(a) Oil and gas exploration and development expenditures

The Company follows the full cost method of accounting whereby all costs related to the exploration for and the development of oil and gas reserves are initially capitalized. Costs capitalized include land acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties, costs of drilling productive and non-productive wells, together with overhead and interest directly related to exploration and development activities and lease and well equipment. Gains or losses are not recognized upon disposition of oil and natural gas properties unless such a disposition would significantly alter the rate of depletion and depreciation.

Costs capitalized are depleted and depreciated using the unit-of-production method based upon gross proven oil and gas reserves as determined by independent and Company engineers. Production and reserves of oil and natural gas are converted to common units of measure based on their relative energy content, where one barrel of oil equates to six thousand cubic feet of natural gas.

The cost of significant unproved properties are excluded from the depletion and depreciation base until it is determined whether proved reserves are attributable to the properties, or until impairment has occurred.

Costs subject to depletion under the full cost method also include estimated future removal and site restoration costs. This would include the cost of production equipment removal and environmental cleanup based upon regulations and economic circumstances at year-end. The current period's provision for future removal and site restoration costs is included in depletion and depreciation expense.

In applying the full cost method, the Company performs a ceiling test which restricts the capitalized costs less accumulated depletion and depreciation, future income taxes and future removal and site restoration costs for each cost centre from exceeding an amount equal to the estimated undiscounted value of future net revenues from proven oil and gas reserves, based on current prices and costs, and after deducting estimated future general and administrative expenses, estimated future removal and site restoration costs, financing costs and income taxes.

The amounts recorded for depletion and depreciation of exploration and development costs, the provision for future removal and site restoration and the ceiling test are based on estimated proven reserves, production rates, future oil and natural gas prices and future costs. By their nature, these estimates are subject to measurement uncertainty and changes in such estimates may have a material impact on the financial statements of future periods.

(b) Depreciation

Other property and equipment are depreciated using the declining balance method at annual rates of 20% to 30%.

(c) Joint venture accounting

Substantially all of the Company's exploration and production activities are conducted jointly with others, and accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

(d) Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit with banks, and term deposits with maturities of 90 days or less.

(e) Income taxes

Income taxes are calculated using the liability method of tax allocation accounting. Under the liability method, income tax assets and liabilities are recorded to recognize future income tax inflows and outflows arising from the settlement or recovery of assets and liabilities at carrying values. Income tax assets are also recognized for the benefits from tax losses and deduction that cannot be identified with particular assets or liabilities, provided those liabilities are more likely than not to be realized. Future income tax assets and liabilities are determined based on the tax laws and rates that are anticipated to apply in the period of realization.

(f) Income (loss) and cash flow from operations per share

Diluted income (loss) and cash flow from operations per share are calculated using the treasury stock method, whereby it is assumed that proceeds on the exercise of dilutive stock options are used by the Company to repurchase Company shares at the weighted average market price during the period.

(g) Flow-through shares

The Company, from time to time, issues flow-through shares to finance a portion of its capital expenditure program. Pursuant to the terms of the flow-through share agreements, the tax deductions associated with the expenditures are renounced to the subscribers. Accordingly, share capital is reduced and a future tax liability is recorded equal to the estimated amount of future income taxes payable by the Company as a result of the renunciations, when the expenditures are made.

(h) Stock based compensation plans

The Company has a stock-based compensation plan, which includes stock options as described in note 6(d).

No compensation expense is recognized when stock options are issued to officers, directors and employees. Any consideration received by the Company on exercise of stock options is credited to share capital.

4. Income taxes

Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial income tax rates of 42.62% to loss before income taxes as follows:

	Period of Commencement of Operations, June 8, 2001 to December 31, 2001
Expected income taxes (recovery)	\$ (157,585)
Increase (decrease) resulting from:	
Non-deductible crown payments, net of Alberta Royalty Tax Credit	6,846
Resource allowance	31,601
Other	3,044
Future tax recovery not previously recognized in Royal Sovereign	(61,735)
Future income tax recovery	\$ (177,829)

The components of future income tax asset (liability) consists of:

Carrying value of property and equipment in excess of available tax deductions	\$ (183,282)
Benefit of tax losses carried forward	151,663
Benefit of undeducted share issuance costs	206,230
Benefit of Alberta royalty tax deduction carried forward	3,174
Future income tax asset recorded	\$ 177,785

Property and equipment

	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties and well equipment	\$ 4,016,331	\$ 65,394	\$ 3,950,937
Other	93,855	13,534	80,321
	<u>\$ 4,110,186</u>	<u>\$ 78,928</u>	<u>\$ 4,031,258</u>

Undeveloped land with a cost of \$106,000 has been excluded from the depletion calculation.

Future removal and site restoration costs are estimated in aggregate to be \$44,400 of which \$909 has been charged to income in the current period.

During the period ended December 31, 2001, the Company capitalized \$11,299 of general and administrative expenses relating to exploration and development activities.

(a) Authorized

Unlimited	common voting shares
Unlimited	preferred shares

(b) Issued

Common shares	Number	Stated Value
Issued for cash	4,593,336	\$ 2,010,060
Issued to effect business combination (note 2)	6,700,200	304,800
Issued on private placement (note 6(c))	4,199,036	2,479,422
	<u>15,492,572</u>	<u>4,794,282</u>
Less: Reduction in respect of income tax		
deductions renounced to subscribers		(183,451)
Current share issuance costs, net of income taxes of \$183,407		(201,825)
		<u>(385,276)</u>
		<u>\$ 4,409,006</u>

(c) Pursuant to an Offering Memorandum dated November 29, 2001, the Company offered up to 5,000,000 common shares at \$0.50 per share and 6,666,000 flow-through common shares at \$0.60 per share. Under the terms of the agreement, the agent receives 8% of the gross cash proceeds and 5% of the number of shares sold under this offering as agent's options. Each agent's option will entitle the agent to purchase one common share at a price of \$0.50 for 18 months from the closing of the offering.

At December 31, 2001, a total of 400,000 common shares at \$0.50 per share, and 3,799,036 flow-through common shares at \$0.60 per share were issued for gross proceeds of \$2,479,422. During the period, a total of 209,952 agent's options have been issued and are outstanding and share issuance costs include \$198,354 in commissions paid to the agent. Included in accounts receivable at December 31, 2001 was \$125,000 in consideration for shares already issued that was received immediately after year-end.

At December 31, 2001, the full flow-through share amount raised of \$2,279,422 was renounced to subscribers of the flow-through shares, of which \$430,433 had been incurred by year-end. The remaining \$1,848,989 will need to be incurred during 2002 on eligible expenditures.

Subsequent to year-end, the Company has issued an additional 4,380,000 common shares at \$0.50 per share for gross proceeds of \$2,190,000 on February 6 and 15, 2002 closing dates.

(d) The Company has established a Stock Option Plan for the benefit of the directors, officers and employees of the Company. The maximum number of shares which may be reserved for issuance under the plan is 2,258,667 common shares. No one person can receive options within a one year period entitling the person to purchase more than 5% of the issued common shares. The plan also provides that the price at which options may be granted cannot be less than the market price of the common shares at the time the option is granted. Options outstanding at December 31, 2001 have a weighted average remaining contractual life of 4.5 years.

A summary of the status of the Company's Stock Option Plan as of December 31, 2001, and changes during the period then ended is as follows:

	Number of Options	Weighted Average Exercise Price
Options outstanding, beginning of period	250,000	\$ 0.15
Granted	2,008,667	\$ 0.30
Options outstanding and exercisable, end of period	2,258,667	\$ 0.28

The Company also has 502,501 agent's options (note 2) exercisable until March 2003 at \$0.30 per common share, and 209,952 agent's options (note 6(c)) exercisable until June 2003 at \$0.50 per common share.

(e) Under the requirements of the Alberta Securities Commission and the Canadian Venture Exchange, a total of 2,383,336 of the issued common shares are held in escrow.

The escrowed shares will be released as to one-third on each of the first, second and third anniversaries of the completion of the Company's qualifying transaction, November 14, 2001 (note 2).

Loss per share and cash used in operations per share is calculated based on the weighted average number of common shares outstanding during the period of 8,231,048. Diluted loss per share and cash used in operations per share is calculated on the assumption that the outstanding options have been exercised at the later of the beginning of the period or the date the options are granted. The exercise of options or warrants would be anti-dilutive and would not affect loss or cash used in operations per share.

The Company has the following rental commitment on its office premises expiring November 30, 2004:

2002	\$ 71,572
2003	71,572
2004	65,607
	<u>\$ 208,751</u>

9. Subsequent event

On January 8, 2002, the Company entered into a credit facility agreement whereby the Company will have available a revolving production loan to a maximum of \$2,000,000. The maximum will be capped at \$900,000 until the Company meets certain criteria set out by the bank. The facility will bear interest at prime plus 1% per annum. The facility is secured by a general security agreement covering all present and after-acquired personal property and a \$5,000,000 debenture providing a fixed charge over all assets and a floating charge over all undertakings of the Company.

10. Related party transactions

Included in general and administrative expenses are \$196,466 in consulting fees to officers and to companies in which officers are sole shareholders. Included in share issuance and acquisition costs are \$87,526 in legal fees to a firm in which a director of the Company is a partner.

These transactions are measured at the exchange amount, which is the amount of consideration established, agreed to and paid by the related parties.

11. Financial instruments**Fair values**

The fair value of accounts receivable and accounts payable and accrued liabilities are approximated by their carrying value due to the short-term maturity of these instruments.

CORPORATE INFORMATION

DIRECTORS

James H. Coleman ^{(2) (3)}

Partner

MacLeod Dixon LLP

Calgary Alberta

Michael L. Rose, P.Geol. ^{(2) (3) (4)}

President & CEO

Duvernay Oil Corp.

Calgary, Alberta

Edward G. Smith ^{(1) (2)}

Managing Partner

The Woodman Financial Group Inc.

Calgary, Alberta

Ian M. Fergusson, C.A., C.F.A. ^{(1) (3) (4)}

Principal

Camcor Capital Inc.

Calgary, Alberta

Lee A. Baker, P.Geol. ^{(1) (4)}

President

Royal Sovereign Exploration Inc.

Calgary, Alberta

OFFICERS

Lee A. Baker, P.Geol.

President

David H. England, P.Geol.

Vice President Development and Operations

Rene J. Levesque, P.Geol.

Vice President Exploration

Robert S. Thurgood

Vice President Land

John E. Polnick, CGA

Vice President Finance

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AUDITORS

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EVALUATION ENGINEERS

Gilbert Laustsen Jung Associates Ltd.

Calgary, Alberta

TRANSFER AGENT

Computershare Trust Company of Canada

Calgary, Alberta

STOCK EXCHANGE LISTING

The Canadian Venture Exchange

Symbol: RSX

⁽¹⁾ Member of the Audit Committee

⁽²⁾ Member of the Compensation Committee

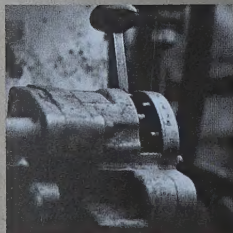
⁽³⁾ Member of the Governance Committee

⁽⁴⁾ Member of the Reserves Committee



ABBREVIATIONS

Bbls	barrels
Boe	barrels of oil equivalent
Boepd	barrels of oil equivalent per day
Bopd	barrels of oil per day
F&D	finding and development
Mboe	thousand of barrels of oil equivalent
Mcf	thousand cubic feet
Mmcf	million cubic feet
Mstb	thousand stock tank barrels
Mstboe	thousand stock tank barrels of oil equivalent
Stb	stock tank barrels



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